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In The

Supreme Court of the United States

October Term, 2005

JOHN P. BURKE, in his Official Capacity as Banking Commissioner of the State of Connecticut,
Petitioner,
v.

WACHOVIA BANK, N.A., and WACHOVIA MORTGAGE CORPORATION,
Respondents.

On Petition For Writ of Certiorari To the United States Court of Appeals for the Second Circuit

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BRIEF OF THE STATES OF FLORIDA, ALASKA, ARIZONA, ARKANSAS, CALIFORNIA, COLORADO, DELAWARE, HAWAII, IDAHO, ILLINOIS, INDIANA, IOWA, KANSAS, MAINE, MARYLAND, MICHIGAN, MINNESOTA, MISSISSIPPI, MISSOURI, MONTANA, NEW HAMPSHIRE. NEW JERSEY, NEW MEXICO, NEW YORK, NORTH DAKOTA, OHIO, OKLAHOMA, OREGON, RHODE ISLAND, SOUTH CAROLINA, SOUTH DAKOTA, TENNESSEE, TEXAS, VERMONT, WASHINGTON, WEST VIRGINIA, WISCONSIN, WYOMING, THE COMMONWEALTHS OF KENTUCKY, PENNSYLVANIA AND PUERTO RICO, AND THE DISTRICT OF COLUMBIA AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

1. Is the interpretation of the Office of Comptroller of the Currency as to the preemption of state law under the National Bank Act entitled to judicial deference?

2. Do the provisions of the National Bank Act and the regulations promulgated thereunder by the Office of Comptroller of the Currency preempt state law licensing and regulatory authority over state-chartered operating subsidiaries of national banks?

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INTEREST OF *AMICI CURIAE*

The States have a compelling interest in the enforcement of laws designed to protect consumers by ensuring that state-chartered mortgage lenders and other providers of financial services do not engage in unscrupulous practices. Respect for both that interest and for principles of federalism compels the conclusion that a self-interested federal agency may not decide by bureaucratic fiat the proper balance of power between the federal government and the States. In holding that a rule promulgated by the Office of the Comptroller of the Currency ("OCC") extending the scope of the OCC's own preemptive authority was nevertheless entitled to deference, the Second Circuit decision not only conflicts with the holdings of other circuit courts, but also threatens to upset the proper federal-state balance and eliminate the States' ability to police dishonorable lenders. Moreover, the Second Circuit's acquiescence to the OCC's expansion of federal preemption to include *state-chartered* subsidiaries of national banks removes *state-chartered* entities from state oversight solely because of their affiliation with national banks. Left untouched, the Second Circuit's decision tenders sole responsibility for consumer protection to the OCC, an agency lacking the resources and the Congressionally-delegated authority to undertake the role currently played by the States. The States thus have a compelling interest in this Court's granting review.

REASONS FOR GRANTING THE PETITION

I. The Second Circuit redefined the scope of deference given to agency regulations.

Permitting administrative agencies to determine the scope of their own preemptive authority -- and affording deference to those determinations -- departs substantially from precedent and eliminates an essential check on the powers of administrative agencies. Since "a preemption determination involves matters of law -- an area more within the expertise of the courts" than within the expertise of an administrative agency, *Colorado Pub. Util. Comm'n v. Harmon*, 951 F.2d 1571, 1579 (10th Cir. 1991), case law determining the preemptive effect of agency regulations, particularly in the banking arena, is abundant. This precedent is properly reviewed and applied by courts, not administrative agencies. *See Univ. of Great Falls v. NLRB*, 278 F.3d 1335, 1341 (D.C. Cir. 2002) (recognizing that courts are "the supposed experts in analyzing judicial decisions").

The Second Circuit for the first time applied the deferential standard of review of *Chevron U.S.A., Inc., v. Natural Resources Defense Council*, 467 U.S. 837 (1984), to a federal agency's determination as to the preemptive effect of its own regulations. Instead of considering for itself whether Congress intended for state law to be preempted in this case, the Second Circuit erroneously deferred to the OCC's own conclusions regarding the preemptive effect of its regulations. By the OCC's own admission, 12 C.F.R. § 7.4006 does not reflect any substantive conclusions of the OCC regarding the scope of the National Bank Act. Rather, it merely reflects the OCC's guess at how a federal court would likely construe the scope of its preemptive authority. *See* Bank Activities and Operations, 66 Fed. Reg. 34784, 34790 ("The section itself does not effect preemption of any State law; it reflects the conclusion we believe a Federal court would reach, even in the absence of the regulation, pursuant to the Supremacy Clause and applicable Federal judicial precedent."). Thus, the Second Circuit afforded

deference to the OCC's guess at the conclusion the court itself would reach, turning the OCC's predictions into a self-fulfilling prophecy.

Although agency regulations may have preemptive effect, *Federal Savings & Loan Association v. De la Cuesta*, 458 U.S. 141, 152-53 (1982), prior to the Second Circuit's decision, no court had ever held an agency may itself determine the preemptive effect of its own regulations. "[I]t seems highly unlikely that a responsible Congress would implicitly delegate to an agency the power to define the scope of its own power." *ACLU v. FCC*, 823 F.2d 1554, 1567 n.32 (D.C. Cir. 1987); *see also* Ernest Gellhorn & Paul Verkuil, *Controlling Chevron-Based Delegations*, 20 Cardozo L. Rev. 989, 1009 (1999) ("[A]gencies have no comparative advantage in reading statutes, and . . . agency self-interest may cloud its judgment"); *Hi-Craft Clothing Co. v. NLRB*, 660 F.2d 910, 916 (3d Cir. 1981) ("Government agencies have a tendency to swell, not shrink, and are likely to have an expansive view of their mission.").

The Comptroller of the Currency himself acknowledged in 2002, that "the OCC has no self-executing power to preempt state law." *See* Press Release, Office of the Comptroller of the Currency, *Comptroller Calls Preemption a Major Advantage of National Bank Charter* (Feb. 12, 2002), http://www.occ.treas.gov/ftp/release/2002-10.doc. Section 7.4006 constitutes an abrupt and substantial departure from this acknowledgement. Thus the OCC's rules "may represent an unprecedented expansion of Federal preemption authority" which "comes without congressional authorization, and without a corresponding increase in budget resources for the agency." Staff of H. Comm. on Fin. Servs., 108th Cong., *Report on Matters to be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005* (Comm. Print 2004) at 15; *see also* 150 Cong. Rec. E692 (daily ed. Apr. 28, 2004) (statement of Rep. Paul) ("This new OCC authority will have far-reaching and unintended consequences. State law governing mortgage brokers, sub-prime lenders, check cashing centers, leasing

companies, and even car dealers could be preempted under the new proposal."); Statement of Congressman Luis Gutierrez, OCC preemption hearing (April 1, 2004), http://financialservices.house.gov/media/pdf/040104lg.pdf ("I think it is clear that we will never agree with the OCC regarding the authority it purports to have."); Report, Democratic Staff of the House Financial Services Committee, *Key Problems with the OCC's Preemption Rule*, http://www.house.gov/banking_democrats/OCC0317.html ("The OCC has inappropriately applied its preemption standard to exempt from state laws, state-chartered operating subsidiaries of national banks. Even if national banks are exempt from certain state laws, there is no reason – or basis in federal law – to extend that preemption to state-chartered operating subsidiaries.").

II. The Second Circuit's decision conflicts with decisions of the Tenth and Eleventh circuits.

In stark contrast to the Second Circuit, the Eleventh Circuit has stated "we do not defer to agency positions, whether formal or informal, on preemption issues." *Bankwest, Inc. v. Baker*, 411 F.3d 1289, 1300 (11th Cir. 2005). Likewise, the Tenth Circuit refused to give deference to an agency's position on preemption, noting a preemption determination involves matters of law -- an area more within the expertise of the courts than an administrative agency. *Colorado Pub. Util. Comm'n v. Harmon*, 951 F.2d 1571,1579 (10th Cir. 1991); *see also Univ. of Great Falls v. NLRB*, 278 F.3d 1335, 1341 (D.C. Cir. 2002) ("We are not obligated to defer to an agency's interpretation of Supreme Court precedent under *Chevron* or any other principle.").

In *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996), this Court recognized the difference between agency interpretations as to the substantive meaning of a statute and interpretations as to the preemptive effect of a statute. *Id.* at 744. "We may assume (without deciding) that the latter question must

always be decided de novo by the courts." *Id.* The question now warrants immediate attention in light of the conflict created by the Second Circuit's decision, and its tremendous importance to the States.

III. The OCC's interest is at odds with the States.

Affording deference to an agency's conclusions regarding the preemptive effect of its own regulations is particularly distressing where the interests of the agency are at odds with those of the States. Indeed, "[i]t would exceed the bounds of fair play to allow an institutionally self-interested advocacy position, which may properly carry a bias, to control the judicial outcome." *See* Robert A. Anthony, "*Which Agency Interpretations Should Bind Citizens and the Courts?*" 7 Yale J. on Reg. 1, 60-61 (1990); *see also Natural Res. Def. Council, Inc. v. Herrington*, 768 F.2d 1355, 1428 (D.C. Cir. 1985) ("To carry much weight, [an agency's] interpretation must be publicly articulated at some time prior to the embroilment of the agency in litigation over the disputed provision.").

The OCC's operations are funded by the same national banks that receive the benefit of its preemptive rulings. "[T]he constituency positively affected by the OCC's position is concentrated, organized and well-funded, and also happens to be the regulated industry." *Wells Fargo Bank of Texas, N.A. v. James*, 321 F.3d 488, 494 (5th Cir. 2003). By contrast, "the constituency which is adversely affected by the decision, though vast, is diffuse, unorganized, and definitionally ill-funded." *Id.* Accordingly, "[i]t may be that these competing interests could better be balanced . . . by a national Congress whose commitments are diverse and universal, or even by the people as they are represented in the state legislatures, than by a solitary institution whose focus is a single industry." *Id.* Given this demonstrable self-interest, affording *Chevron* deference to decisions of the OCC or any federal agency so situated, on the

issue of preemption is as contrary to the public welfare as it is legally flawed.

IV. Untoward expansion of OCC preemption erodes the States' regulation of state-chartered corporations, threatens the dual banking system and undermines state consumer protection laws.

The Second Circuit's decision ratifies the OCC's attempts to convert state-chartered corporations into creatures of federal law without permission of the chartering States. Left unchecked, this could motivate financial institutions to give up their state charters and either obtain a federal charter or merge with a national bank, effectively destroying the dual banking system valued by both Congress and the States.[1]

States have always exercised comprehensive supervision over the corporations they charter and have licensed and regulated corporations chartered by other States transacting business within their borders. "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations . . ." *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987). The Second Circuit ignored the States' unquestioned primacy in regulating state-chartered corporations and unlawfully invaded sovereign interests protected by the Tenth Amendment by attempting to transform state-chartered corporations into creatures of federal law without the chartering States' permission. This Court held in *Hopkins Federal Savings & Loan Ass'n v. Cleary*, 296 U.S. 315 (1935), that a federal statute violated the Tenth Amendment by allowing state-chartered savings institutions to convert to federal charters without state permission. "How [these institutions] shall

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[1] A number of "state-licensed businesses are now considering becoming operating subsidiaries of national banks in order to exempt themselves from state laws." *See Review of the National Bank Preemption Rules Before the S. Comm. on Banking, Housing, & Urban Affairs*, 108th Cong. (2004) (statement of Gavin M. Gee, Director of Finance, State of Idaho), at 5.

be formed, *how maintained and supervised*, and how and when dissolved, are matters of governmental policy, which it would be an intrusion for another government to regulate by statute or decision, except when reasonably necessary for the fair and effective exercise of some other and cognate power explicitly conferred." *Id.* at 337 (emphasis added). *See also Chicago Title & Trust Co. v. 4136 Wilcox Bldg. Corp.*, 302 U.S. 120, 127 (1937) (holding that § 77B of the federal Bankruptcy Act did not allow shareholders to file a bankruptcy petition on behalf of a corporation whose charter had expired under state law, because any such filing would be "an intrusion by the Federal Government on the powers of the [chartering] State").

That the state-chartered corporations at issue are operating subsidiaries of national banks does not negate the authority of the state. "For at least 30 years, national banks have been authorized to invest in operating subsidiaries that are engaged only in activities that national banks may engage in directly." S. Rpt. No. 106-44 at 8 (1999). These operating subsidiaries are not themselves national banks with national charters. Rather, they are state created entities incorporated under state law. The OCC has not questioned previously the authority of States to regulate, license, and examine these state-chartered corporations. Thus, the OCC's recent attempts to preempt state authority constitute a dramatic departure from its historical view of state licensing and regulation.[2]

In an area where, as here, state law traditionally has applied, Congressional intent to preempt state law must be clearly manifested. *See Gregory v. Ashcroft*, 501 U.S. 452, 461 (1991). But Congress has *not* authorized the OCC to disregard

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[2] Even where deference may properly be applied to agency determinations, this Court has refused to do so where agencies have shifted from their own historical views. *See FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159-160 (2000) ("Given this history and the breadth of the authority that the FDA has asserted, we are obliged to defer not to the agency's expansive construction of the statute, but to Congress' consistent judgment to deny the FDA this power.").

the separate corporate existence of national banks and their operating subsidiaries. The National Bank Act provides absolutely no basis for ignoring the fundamental corporate distinctions between a national bank parent and its subsidiary. In fact, federal statutes draw a sharp distinction between "national banks," on the one hand, and their "subsidiaries" and "affiliates" on the other. The "incidental powers" granted by 12 U.S.C. § 24 Seventh, the real estate lending powers provided in 12 U.S.C. § 371, and the limitations on "visitorial powers" under 12 U.S.C. § 484, apply only to "national banks." A "national bank" is an institution that (i) has filed articles of association and an organization certificate with the OCC, pursuant to 12 U.S.C. §§ 21-24 & 26; (ii) has received a certificate of authority from the OCC to carry on a "banking business" under 12 U.S.C. §§ 24 & 27; and (iii) is entitled to become a member of the Federal Reserve System under 12 U.S.C. §§ 282 & 287. Operating subsidiaries, on the other hand, are chartered as nonbank corporations under state law, do not receive certificates of authority to carry on a "banking business," and cannot become members of the Federal Reserve System. Accordingly, the preemptive authority the OCC possesses with respect to national banks under Sections 24 Seventh, 371 and 484 cannot be simply extended to include operating subsidiaries.

The legal separation between a subsidiary and its parent corporation is a "general principle of corporate law deeply ingrained in our economic and legal systems." *United States v. Bestfoods*, 524 U.S. 51, 61 (1998) (citation and internal quotation marks omitted). Federal courts have consistently interpreted federal statutes in a manner that upholds corporate separation and other longstanding principles of state corporate law, absent clear evidence that Congress intended a different result. *See, e.g., Dole Food Co. v. Patrickson*, 538 U.S. 468, 475-76 (2003) (refusing to conclude that, "as a categorical matter, all subsidiaries are deemed to be the same as the parent corporation," because "[t]he text of the [relevant statute] gives no indication that Congress intended us to depart from the

general rules regarding corporate formalities"); *Bestfoods*, 524 U.S. at 62 (rejecting a proposed reading of a pollution control statute ("CERCLA") that would impose automatic liability on a parent corporation for the acts of its subsidiary, because "nothing in CERCLA purports to reject this bedrock principle [of corporate separation], and against this venerable common law backdrop, the congressional silence is audible"); *CTS Corp.*, 481 U.S. at 85, 86 (refusing to construe a federal statute to "pre-empt a variety of state corporate laws of hitherto unquestioned validity," because the "longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all [such] state laws . . . it would have said so explicitly").

As the OCC has itself recognized, "the use of a separate subsidiary structure can enhance the safety and soundness of conducting new activities by distinguishing the subsidiary's activities from those of the parent bank (as a legal matter) and allowing more focused management and monitoring of its operations." Rules, Policies and Procedures for Corporate Activities, 61 Fed. Reg. 60,342, 60,354 (Nov. 27, 1996); *Wachovia Bank v. Burke*, 414 F.3d 305, 319 (2d Cir. 2005) ("[T]he OCC has long maintained that an operating subsidiary is legally distinct from the parent bank."). Allowing national banks to secure the legal benefits of operating through a subsidiary while still enjoying the benefits of having a national charter finds no basis in the National Bank Act. *See* Report, Democratic Staff of the House Financial Services Committee, *Key Problems with the OCC's Preemption Rule*, http://www.house.gov/banking_democrats/OCC0317.html ("If a national bank wishes to engage in activity and benefit from national bank preemptions, it can perform the activity in the national bank. However, if it wishes [to] minimize corporate liability by establishing a separate state-chartered operating subsidiary, that entity must be subject to state law and enforcement. Otherwise, the OCC is allowing national banks to 'have their cake and eat it too.'").

Finally, the OCC was not designed to function as a consumer protection agency and lacks the resources to effectively police the conduct of all national banks and their state-chartered subsidiaries. For as long as national banks have controlled state-chartered operating subsidiaries, the States have enforced, with the approval of Congress, laws designed to protect consumers against predatory lending and other unscrupulous lending practices. The House Financial Services Committee questioned whether the OCC has sufficient administrative resources to investigate all consumer complaints for 2,150 national banks -- from a single customer assistance center -- let alone investigating all operating subsidiaries of national banks. The OCC's new rules "necessitate that the OCC investigate all consumer complaints for 2150 national banks in the 50 states from a single customer assistance center which only takes calls from 9:00 am to 4:00 pm, on four days each week, excluding federal holidays. There are currently only 40 full time staff members allocated for these tasks at the OCC." Staff of H. Comm. on Fin. Servs., 108th Cong., *Report on Matters to be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005* (Comm. Print 2004), at 16. The OCC's list of operating subsidiaries of national banks, which includes such state chartered institutions as CashZone Check Cashing Corp., CitiCapital Trailer Rental, Inc., Southern Courier Service, Systems & Services Technologies, Inc, demonstrates the tremendous scope of activities the OCC is attempting to shelter from state regulation. Office of Comptroller of Currency, *Annual Report of National Bank Operating Subsidiaries That Do Business Directly With Consumers* (2005), http://www.occ.treas.gov/consumer/Final%20Op%20Sub%20Version%20for%20PDF_4_08.pdf. These state-chartered corporations have long been subject to state licensing and regulation. Given the OCC's demonstrably inadequate resources, the Second Circuit's decision will undermine consumer protection in the banking context.

By contrast, "state banking agencies and state attorney generals' offices employ nearly 700 full time examiners and attorneys to monitor and enforce consumer law compliance."[3] Staff of H. Comm. on Fin. Servs., 108th Cong., *Report on Matters to be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005* (Comm. Print 2004), at 16. In the area of abusive mortgage lending practices alone, state bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions. *Id.* Unlike the OCC, the States have the resources to monitor and enforce consumer law compliance.

[3] The extent to which States may bring actions against national banks to enforce consumer protection laws is an issue currently pending before other courts and is not an issue in this case.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

RESPECTFULLY SUBMITTED,

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